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SUBJECT: Honduras: 2003 Macroeconomic Overview

REF: Tegucigalpa 2435

1. SUMMARY: Post submits its annual macroeconomic summary for Honduras for the year 2003, based on the official economic statistics released by the GOH in the fall of 2004. Reftel contains information on imports, exports, and the trade deficit; this cable contains information on economic growth, prices, wages, and employment. Unless cited otherwise, all figures are from the Central Bank of Honduras' annual report.

2. The rate of economic growth in Honduras increased from 2.5 percent in 2002 to 3.2 percent in 2003, with the maquila sector, tourism, and family remittances all registering strong growth. The inflation rate reached 6.8 percent, its lowest level in over a decade, and flows of foreign direct investment increased by 39 percent. However, unemployment rose, with the broadest measure of unemployment (the percentage of the economically active population with "employment problems") showing a sharp increase from 33 to 42 percent. END SUMMARY.

ECONOMIC GROWTH AND ACTIVITY

3. The Honduran economy grew at a rate of 3.2 percent in 2003, up from 2.5 percent in 2002. This was the second highest growth rate in Central America, after Costa Rica's. However, population growth of 2.6 percent meant that per capita GDP growth was only 0.6 percent. The expansion has been driven by growth in the maquila industry (offshore assembly for re-export), family remittances, and tourism. All sectors of the economy registered growth except for public administration and defense, which fell by 2 percent due to the public spending austerity policy implemented by the GOH. The sector that increased the most in percentage terms was the construction sector (13.8 percent), which is recovering after three years of stagnation; public construction grew 17.2 percent while private construction grew by 10.9 percent. The manufacturing sector grew by 3.7 percent, a similar rate to that of last year, and the agricultural sector, which currently accounts for 12.8 percent of GDP, increased by only 1.9 percent. Within the service sectors, telecommunications grew by 3.5 percent, reflecting the recent expansion of cellular telephony and increased investment in the sector.

REAL GDP GROWTH RATE

| Year | Percent | Per capita |
|------|---------|------------|
| 1997 | 5.1 | 2.5 |
| 1998 | 2.9 | 0.3 |
| 1999 | -1.9 | -4.4 |
| 2000 | 5.2 | 2.5 |
| 2001 | 2.6 | 0.0 |
| 2002 | 2.5 | 0.0 |
| 2003 | 3.2 | 0.6 |

REAL GDP BY ECONOMIC ACTIVITY:
PERCENTAGE INCREASE OVER PREVIOUS YEAR

| Activity | 2001 | 2002 | 2003 |
|-----------------------------|------|-------|------|
| Agriculture | -0.5 | 4.8 | 1.9 |
| Mining | -0.8 | 5.0 | 3.2 |
| Manufacturing Industry | 5.2 | 2.8 | 3.7 |
| Construction | -5.2 | -14.6 | 13.8 |
| Electricity, Water, Gas | -1.8 | 5.6 | 7.9 |
| Transportation, Storage | 5.3 | 3.2 | 3.7 |
| Stores, Restaurants, Hotels | 3.0 | 2.8 | 3.1 |
| Financial Institutions | 3.1 | 2.2 | 1.7 |
| Housing | 3.9 | 3.9 | 4.2 |
| Public Admin. and Defense | 8.7 | 7.2 | -2.0 |
| Other Services | 12.6 | 7.2 | 3.5 |
| Real GDP (All Activities) | 2.6 | 2.7 | 3.2 |

4. The GOH has given priority to increased tourism

development and hopes it will generate economic growth and substantial employment. The key geographic areas of focus include the Bay Islands and the northern coast, and the "Mayan Route" from Copan to other archeological sites in Guatemala and Mexico. The government's goal is to reach one million tourists and USD 500 million in income in 2004. According to data released by the Honduran Institute of Tourism, the number of tourist arrivals rose by 12.4 percent in 2003, to 886,600. Cruise ship visitors increased by 10.6 percent over 2002, to reach 135,000 people. The tourist industry continues to recover following the September 11, 2001 attacks and has become the third largest economic activity in the country after the maquila and agricultural sectors.

15. In early 2004, the Minister of Tourism announced that the Honduran Institute of Tourism plans to proceed with the USD 140 million Tela Bay project, which will include a luxury resort, golf courses, access to local Garifuna villages, scuba diving, and (pending completion of an airport in Copan) day trips to the Mayan ruins of Copan. The project was given a boost in 2003 by the announcement of the Spanish and Italian governments confirming the necessary financing. In January 2004, Congress authorized the transfer of 311 hectares of government land to a mixed-equity company, in which the Honduran Institute of Tourism will be a partner. In September 2004, President Maduro led a senior GOH delegation to the Dominican Republic to drum up additional private sector interest in investing in the project.

TOURISM: VISITORS AND INCOME

| Year | Visitors ('000) | Foreign Exchange Income (USD Million) |
|------|---------------------|--|
| 1999 | 428.1 | 195.0 |
| 2000 | 688.4 | 259.8 |
| 2001 | 672.0 | 274.6 |
| 2002 | 788.1 | 341.5 |
| 2003 | 886.6 | 373.2 |

Source: Ministry of Tourism.

FOREIGN DIRECT INVESTMENT (FDI)

16. According to Central Bank data, FDI flows to Honduras in 2003 totaled USD 198 million, a 39 percent increase over 2002, though still well off the historical high of USD 282 million reached in 2000. The U.S. continues to be the dominant source of FDI in Honduras; while a country breakdown for 2003 is not yet available, 2002 figures show that 38 percent of total FDI flows to Honduras were from the United States.

FOREIGN DIRECT INVESTMENT BY COUNTRY OF ORIGIN

(USD '000s)

| | 1999 | 2000 | 2001 | 2002 |
|-----------------|-----------|-----------|-----------|-----------|
| United States | 113,855.1 | 64,240.6 | 52,600.0 | 54,500.0 |
| Canada | 55,099.6 | 36,057.9 | 15,057.0 | 18,115.0 |
| El Salvador | 13,907.7 | 7,878.8 | 9,240.0 | 11,798.0 |
| Costa Rica | 6,442.5 | 21,186.6 | 24,106.6 | 9,831.5 |
| Panama | 19,474.8 | 15,099.7 | 18,088.0 | 8,795.0 |
| Italy | -3,606.0 | 13,624.8 | 7,624.0 | 6,175.0 |
| Guatemala | 3,354.5 | 11,084.8 | 10,847.0 | 6,046.0 |
| Spain | 5,884.3 | 7,784.5 | 9,784.5 | 5,390.0 |
| United Kingdom | 2,567.4 | 14,956.7 | 4,289.0 | 4,790.0 |
| Japan | 124.0 | 0.0 | 1,150.6 | 1,188.2 |
| Switzerland | 6,948.1 | -4,050.9 | -1,250.0 | 543.0 |
| Germany | 156.7 | 218.6 | 188.6 | 219.0 |
| Mexico | 4,612.9 | -138.8 | 207.0 | 223.0 |
| Other countries | 8,515.6 | 94,056.3 | 43,068.9 | 15,246.9 |
| Total | 237,337.2 | 281,999.6 | 195,001.2 | 142,860.6 |

Country breakdown for 2003 not yet available.

PRICES AND WAGES

17. Inflation, as measured by the Consumer Price Index, rose by 6.8 percent in 2003, the lowest annual inflation rate in over a decade, and 1.3 percentage points lower than the rate in 2002. (Note: Sharp rises in energy inputs have led to a spike in inflation in 2004, with rates currently estimated at nearly 9 percent annualized - higher than in 2003, but still moderate by recent historical standards. End note.) Factors contributing to the low inflation rate included the stability of the real exchange rate (carefully maintained through a crawling peg nominal exchange rate that devalues

at approximately 6 percent per year), the application of prudent monetary policy, and an increased domestic supply of basic grains due to increases in national production.

18. Prices of telecommunications and cement fell due to increased competition in both sectors: specifically, the launching in November of Megatel, a Swedish-Honduran company in the telecommunications sector, and in September of Cemento Uno, a Honduran partner with Taiheyo Cement, the leading Japanese cement manufacturer. (Note: By mid 2004, unfair competition and predatory pricing practices had driven Cemento Uno out of business, with a resultant sharp rise in cement prices. Lacking an effective competition law, the GOH has had to resort to setting prices for cement to restrain monopoly rent-seeking by the surviving firm. End note.) However, increases in the prices of gasoline and public transportation partially offset the low inflation rates in other parts of the economy.

19. The latest revision of the minimum wage (an increase of 12 percent for workers in agriculture and approximately 9 percent for most other workers) was implemented in spring 2004, and more than compensated for the annual rate of inflation. Wage and benefits packages for other professions, notably teachers and doctors, grew far faster than inflation, since they are based on multiples of the minimum wage. New negotiations are expected to start in November of this year for the 2005 minimum wage increase.

INFLATION

| Year | Percent |
|------|---------|
| 1994 | 29.1 |
| 1995 | 26.9 |
| 1996 | 25.2 |
| 1997 | 12.7 |
| 1998 | 15.7 |
| 1999 | 11.0 |
| 2000 | 10.1 |
| 2001 | 8.8 |
| 2002 | 8.1 |
| 2003 | 6.8 |

EMPLOYMENT

10. Employment data is collected by the National Institute of Statistics (INE) through a household survey conducted each May and September. INE calculates four measures of unemployment: open unemployment, visible sub-unemployment, invisible sub-unemployment, and, most broadly, the percentage of the economically-active population with employment problems. On all four measures, unemployment increased from 2002 to 2003, and early figures from 2004 show the increase continuing. By the most narrow definition, open unemployment rose from 3.8 percent in September 2002 to 5.1 percent in 2003, and to 5.9 percent in May 2004, with the majority of the unemployed living in urban areas and belonging to the younger segment of the labor force. The broadest measure of unemployment, the percentage of the economically active population with employment problems, showed a significant increase of 8.6 percentage points in 2003, from 33.2 percent to 41.8 percent. Employment in the maquila sector, however, continued to rise, growing 8.2 percent to 114,237 employees in 2003.

EMPLOYMENT INDICATORS

| | 2002 | 2003 |
|---|------|------|
| Economically Active Population (million) | 2.44 | 2.56 |
| Open Unemployment (percent) | 3.8 | 5.1 |
| Visible Sub-employment (percent) | 4.8 | 7.1 |
| Invisible Sub-employment (percent) | 26.6 | 29.6 |
| Economically-Active Population with Employment Problems (percent) | 33.2 | 41.8 |

Source: National Institute of Statistics (INE).

OPEN UNEMPLOYMENT

| Year | Percent of Labor Force |
|----------------|------------------------|
| September 1998 | 3.0 |
| September 1999 | 3.3 |
| September 2000 | N/A |
| September 2001 | 3.9 |
| May 2002 | 4.1 |
| September 2002 | 3.8 |
| May 2003 | 5.4 |
| September 2003 | 5.1 |
| May 2004 | 5.9 |

Source: National Institute of Statistics (INE).

MAQUILA SECTOR EMPLOYMENT

| Year | Employees | Pct Change |
|------|-----------|------------|
| 1998 | 98,905 | 18.5% |
| 1999 | 103,271 | 4.4% |
| 2000 | 106,530 | 3.2% |
| 2001 | 94,416 | -11.4% |
| 2002 | 105,556 | 11.8% |
| 2003 | 114,237 | 8.2% |

Palmer